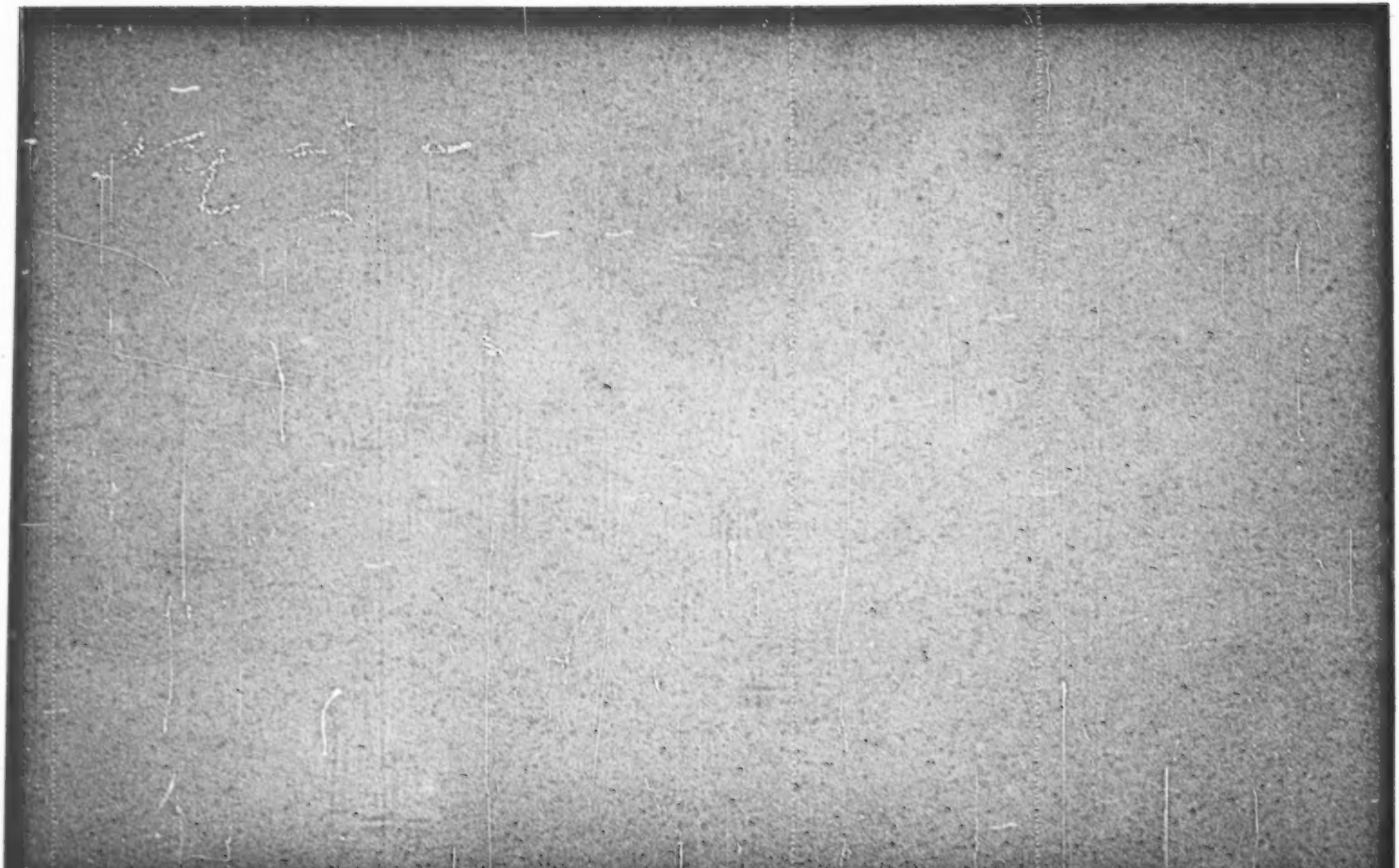

SUPREME COURT, U. S.
NOV 8 1974
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term 1973

No. 73-1657

ESTATE OF JOSEPH M. MEADE, DECEASED, FIRST NATIONAL BANK OF FLORENCE, EXECUTOR, and HAZEL B. MEADE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE

WILLIAM S. and ELIZABETH KING,
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v.

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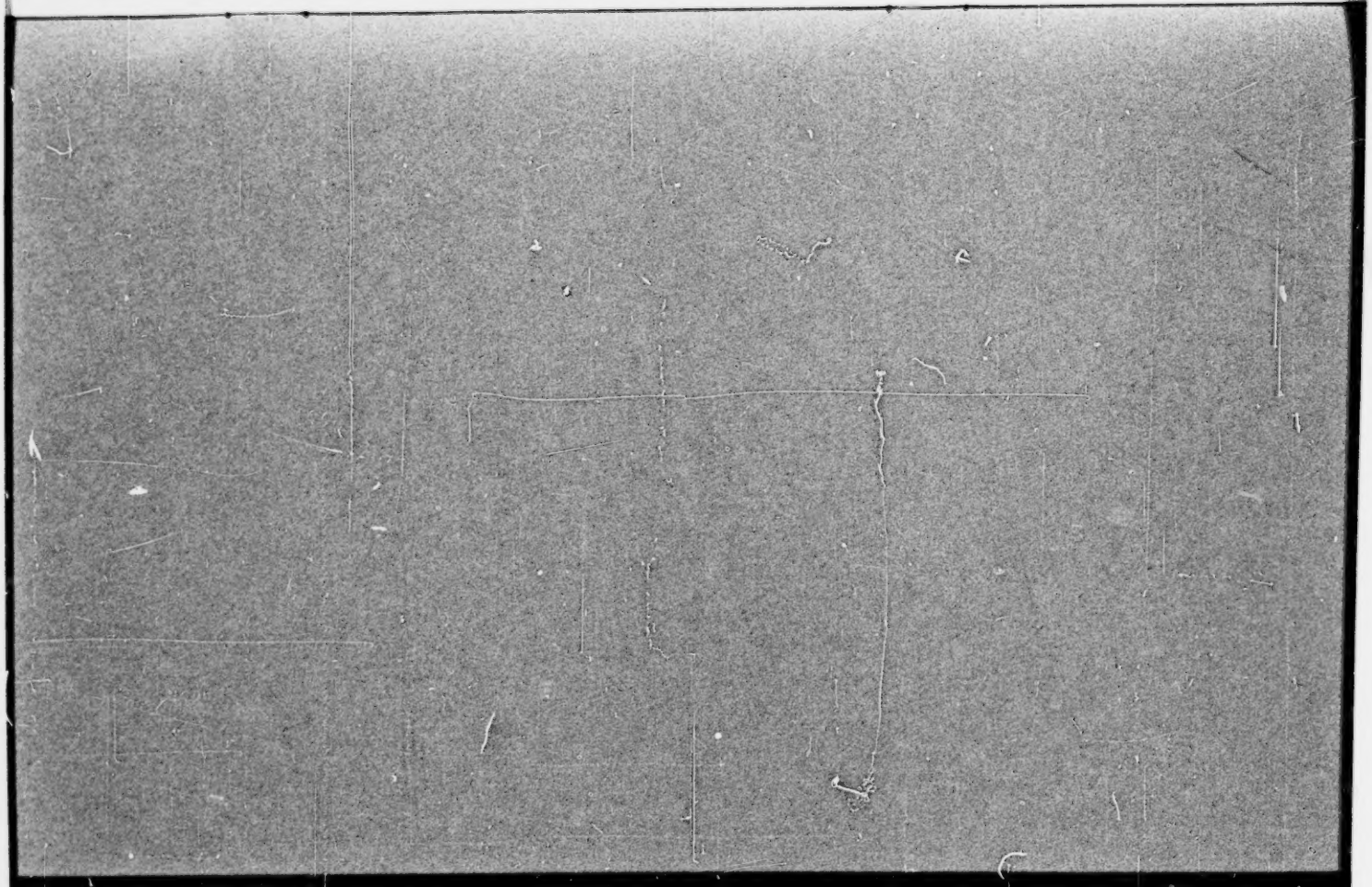
MEMORANDUM IN SUPPORT OF PETITIONERS REQUEST FOR REHEARING ON A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPPEALS FOR THE FIFTH CIRCUIT



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MEMORANDUM IN SUPPORT OF PETITIONERS REQUEST FOR REHEARING ON A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioners filed a petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit. The Court requested that a response be filed in this case to reach the office of the clerk on or before August 30, 1974. The respondent filed in the office of the clerk on September 6, 1974, a Memorandum For the Respondent In Opposition.

The Memorandum In Opposition contained the following statement of law (page 4):

> "Indeed, petitioners' emphasis on the historical roots of the antitrust claim implicitly suggests that they are entitled to the same ordinary deduction treatment that their corporation would have received had it incurred these costs in enforcing the claim prior to the liquidation. Such an assumption overlooks the decisive fact of the corporate liquidation. Prior to that event, the claim was a business property in the hands of the corporation, the recovery of which would have been taxable as ordinary income. The costs incurred by the corporation in seeking recovery of such an ordinary income item would have beeen deductible from ordinary income. However, once the corporation liquidated and distributed the claim to petitioners, it took on the nature of an investment or capital asset in the hands of the shareholders."

THE ABOVE STATEMENT OF LAW IS IN ITS ENTIRETY INCORRECT AND IS NOT SUPPORTED BY ANY STATUTE, REGULATIONS, RULINGS OR CASES AND IS IN DIRECT CONFLICT WITH ALL EXISTING LAW ON THE SUBJECT.

The respondent, in the above statement of law, states that the deductibility of the expenses for collecting a *claim* depends on whether the *claim* was business property in the *hands* of the corporation, or an *investment* or *capital asset* in the *hands* of the shareholders. Such a statement of law is directly contradictory to all decided cases on this issue. It has long been a basic principle of law that the deductibility of expenses for collecting a claim depends upon the transaction from which the claim arises, and not on how the *claim is held* by the taxpayer.

This Court, in *Kornhauser* v. *United States*, 276 U.S. 145, 48 S.Ct. 219, in considering the deductibility of legal expenses incurred by a taxpayer in defending against a claim brought by a former business partner, in regard to a transaction arising out of the taxpayers former business, held that the expenses were deductible even though at the time the expenses were paid, the taxpayer was no longer in business. This Court stated "where a suit or action against a taxpayer is directly connected with or . . . proximately resulted from, his business, the expense incurred is a business expense. . . ." 276 U.S. at 153, 48 S.Ct., at 220. This principle was reaffirmed by this Court's decision in *United States* v. *Gilmore*, 83 S.Ct. 623 (1963) in which the Court stated "The principal we derive from these cases is that the characterization as 'business' or 'personal', of the litigation costs of resisting a claim depends on whether or not the claim *arises* in connection with the taxpayer's profit-seeking activities." 83 S.Ct. at 629 (emphasis added). The exact principle, which the respondent argues to be the law in this case, was rejected by this Court in *United States* v. *Hilton Hotels Corporation*, 90 S.Ct. 1037. In this case, Hilton argued that the deductibility of the expenses of litigating a *claim* in its *hands* (to determine the purchase price of stock) should be a business expense since the *claim* had been created in the *hands* of its' predecessor. The Court specifically rejected this argument, 90 S.Ct. at 1309, and held that the deductibility of the expenses in resisting the claim in the *hands* of Hilton must be determined by reference to the litigation of its' predecessor which created the claim. It is clear from the above, that the law, as expressed by this Court, is that the deductibility of expenses in collecting a claim must be determined by the transaction from which the

claim arises and not whether the *claim* is *held* as a business property or an investment or capital asset by the taxpayer.

All other courts (other than the court below in its decisions in this case), including the respondent's own rulings, have held that the deductibility of legal fees are to be determined by reference to the transaction from which the litigation arose. *Clark Oil & Refining Corp.* v. *United States*, 473 F.2d 1217 (CA 7th Cir. 1973); *Ransburg* v. *United States*, 440 F.2d 1140 (CA 10th Cir. 1971); *Helgerson* v. *United States*, 426 F.2d 1293 (CA 8th Cir. 1970); *Beerman et al* v. *United States*, 390 F.2d 638, (CA 6th Cir. 1968); *Lucas et ux* v. *Commissioner*, 388 F.2d 472 (CA 1st Cir. 1967); *Marcello et al* v. *Commissioner*, 380 F.2d 499 (CA 5th Cir. 1967); *Nadiak* v. *Commissioner*, 356 F.2d 911 (CA 2nd Cir. 1966); *Peckham* v. *Commissioner*, 327 F.2d 855 (CA 4th Cir. 1964); *Spangler et al* v. *Commissioner*, 323 F.2d 913 (CA 9th Cir. 1963); *George Eisler*, 59 T.C. 634 (1970); *Messina* v. *United States*, Ct.Cl. No. 279-72 (1973), 73-2 USTC Par. 9508; Revenue Ruling 68-662, 1968-2 C.B. 69.

The respondent's memorandum contends that section 331(a) transforms the tax characteristic of a claim when it is distributed in liquidation "from a *business property* in the *hands* of the corporation to an *investment* or *capital asset* in the *hands* of the stockholder." (emphasis added) Even if the incorrect premises of the respondent is disregarded, that the proceeds of a claim is taxed in accordance with how the claim is held by the taxpayer, the basic premise of the respondent cannot be reconcilled with existing law. Section 331 provides only that "amounts distributed in complete liquidation of a corporation shall be treated as in full payment or

exchange for the stock." This section determines how a liquidation distribution will be taxed. There is no provision in this section which changes the nature or character of an asset distributed in a corporate liquidation into an investment or capital asset. The Treasury Department, for example, has long taken the position that a corporate liquidation, even though it involves a distribution of assets, upon a surrender of the stock of a stockholder is not in the traditional sense as sale or exchange. See: *Merten's Law of Federal Income Taxation*, Vol. 3B, Section 22.97, p. 690, F.N. 53.

The Tax Court's opinion in this case, which was based on the Second Circuit Court of Appeals holding in *Commissioner* v. *Doering*, 335 F.2d 738 (CA 2nd Cir. 1964) held that the origin "test requires inquiry into the origin character of the claim which is the subject of litigation . . . . The character of the claim is therefore, collection of income. Its origin was the alleged violations of the antitrust laws by Kaiser Aluminum. By 'origin' of the claim, we do not construe that to mean how the claim was acquired by the taxpayers who pursue it, but instead we conclude that it means the event which gave rise to the claim." The Fifth Circuit Court of Appeals opinion in the instant case held that the claim "as it rested in the the *hands* of these taxpayers—had its *origin* in the process of the disposition of their stock in Terrace Corporation" (emphasis added). This holding is a misapplication of this Court's origin of litigation rule and is contradictory to the expressed opinions of this Court, and all decided law on the subject.

SUMMARY

It is clear from the above, that the respondent's memorandum filed in opposition did contain substantial errors in the statement of law in this case which could have inadvertently influenced this Court. The petitioners believe that these errors of law, and the late filing of the respondent's memorandum resulted from the extraordinary appellate workload placed on the Solicitors General Office at the beginning of this term of Court. Because of the late filing of the respondent's memorandum and the errors contained therein the Court did not have the issues of this case properly before it prior to its consideration of the petitioners writ of certiorari. In order for the issues of this case to be properly placed before this Court, the petitioners respectfully request this Court to direct the respondent to file an answer to this Memorandum In Support Of Petitioners Request for Rehearing and if the respondent's memorandum in opposition did contain substantial mistatement of the law in this case, then this Court will grant the petitioners a rehearing on the writ of certiorari to the Fifth Circuit Court of Appeals.

Respectfully Submitted,

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P. O. Box 757
Decatur, Alabama 35601
COUNSEL FOR PETITIONERS

CERTIFICATE OF COUNSEL

As counsel for the petitioners, I hereby certify that this memorandum in support of petitioners request for rehearing on a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58(2).

J. Gilmer Blackburn
P. O. Box 757
Decatur, Alabama 35601
COUNSEL FOR PETITIONERS

CERTIFICATE OF SERVICE

I hereby certify that on the ..... day of ....., 1974, three copies of the Memorandum In Support of Petitioners Request For Rehearing on a Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit was mailed, postage prepaid to Robert H. Bork, Solicitor General, Department of Justice, Washington, D.C. 20530.

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COUNSEL FOR PETITIONERS